

Information regarding gross receipts and merchandise that is returned may be found at 86 Ill. Adm. Code 130.401. (This is a GIL.)

May 31, 2005

Dear Xxxxx:

This letter is in response to your letter dated March 8, 2004, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

This is to request a ruling of the Department with respect to the application of Illinois, retailers' occupation ('ROT') tax to merchandise returned to our client under its extended warranty plans providing for product replacement in lieu of product repair ('Plans').

FACTS

Our client is a retailer of consumer electronics and offers extended warranty coverage under the Plans on certain types of merchandise for an additional charge. If a customer purchases a Plan for his/her product, and the product fails to perform in accordance with the manufacturer's specifications during the term of the Plan, the customer will be refunded the original sales price and the sales tax paid for the product in the form of a gift card. The customer can use the gift card to purchase a replacement product of his/her choosing at the retailer's location. The Plans available from our client are separate from any warranties offered by the product manufacturers.

Customers purchasing the Plan are bound by the terms of a contract with a third-party obligor, but our client is designated as the Plan Administrator and Service Provider. The contract indicates that any defective product claims under the Plan are to be sent to our client and that the customer will be reimbursed in the form of a gift card issued by our

client. The vehicle for funding the Plan is a reserve that is created by our client, which consists of a percentage of the sales price of each plan. The reserve is held in trust by the third-party obligor, but can be drawn down by our client each time that a customer makes a defective product claim under the Plan. The obligations under the Plan are also underwritten by an insurance company which is related to the third-party obligor.

When a customer seeks to return a defective product under the Plan, the process begins with the customer calling our client's toll-free telephone number or accessing our client's website to obtain shipping instructions and mailing labels. The customer then ships the defective product to our client's warehouse for processing. At the warehouse, our client's own personnel open and check the returned merchandise and make a determination as to whether the items are eligible for return under the provisions of the Plan. The third-party obligor discussed above has no responsibility with respect to the handling of returned merchandise, nor does it take title to the returned merchandise (by agreement, our client holds ownership in and all salvage rights associated with the returned merchandise under the Plan).

As noted above, payment to the customer under the Plan is made by means of a gift card. These gift cards are issued by our client directly. Our client will issue the gift card to the customer in the amount of the original sales price of the product plus sales tax paid, and then makes a claim against the reserve established with its third-party obligor.

Thus, *in summary*, our retail client continues to manage the returned merchandise function, its personnel actually accept the returned merchandise, the original purchase price plus sales tax are refunded directly to the customer, and those refunds are from our client's own funds in the form of a gift card. The third-party obligor has no customer-facing responsibilities, with its only substantive role being to manage the reserve from which our client may draw down funds in the event of a merchandise return under the Plan.

RULING REQUESTED

Our client wishes to confirm that any amounts of sales tax refunded to customers under the Plan can be used as offsetting deductions from gross sales on our client's Illinois ROT returns.

DISCUSSION

Under Illinois Regulation, 86 Ill. Adm. Code 130.401(b), retailers are allowed to take a deduction from their taxable gross receipts for amounts representing refunds made to customers for returned merchandise. Further, this regulation also provides that retailers should refund any use tax collected on behalf of the customer when refunding the purchase price of returned merchandise.

As such, the keys to the deduction appear to be that the retailer (1) refunds the purchase price and (2) refunds the tax paid. In this case, our retail client meets both of those tests. Although the customer is bound by a contract for the Plan with a third party, our client is the Plan Administrator and Service Provider and carries out all aspects of the return transaction:

- The customer contacts our client directly to arrange the return;
- The returned merchandise is sent to and received by our client;

- Our client repays the customer the original purchase price and tax out of its own funds; and
- Our client has all rights to the returned merchandise.

Thus, in all material respects, the customer deals directly and exclusively with our client, who was the vendor in the original sale. Since the return is made to the original vendor and the original vendor issues the refund, we believe that the requirements of Regulation, 86 Ill. Adm. Code 130.401(b) should clearly be met by our client and the returned goods deduction should therefore be allowed by the Department.

We recognize that the insertion of the third-party obligor into the transaction may differ from traditional returned merchandise scenarios, but we believe it should have no consequence for our client's ability to deduct these merchandise returns from its gross taxable sales. Again, this is because our client still manages the return process and issues the refund to the customer out of its own funds. As noted above, the role of the obligor is essentially reduced to managing the reserve from which our client can draw down funds to cover its refunds to customers under the Plan.

Based on the facts presented, we would greatly appreciate your confirmation, in the form of a ruling, that the deduction for returned merchandise remains available to our retail client for returns made under the Plan. Thank you in advance for your guidance on this issue. If you should have any questions, please feel free to call me.

DEPARTMENT'S RESPONSE

The Department is without sufficient information to determine the exact nature of the relationship, and therefore, the tax obligations of the parties involved in these transactions. In order to clearly understand the exact relationship of the parties and the nature of the transactions, the Department would need to examine the contracts and agreements between all of the parties involved.

Information regarding gross receipts and merchandise that is returned may be found under the Department's regulations at 86 Ill. Adm. Code 130.401. A retailer may deduct from his or her gross receipts any refunds made during the preceding return period if the retailer included those receipts in the retailer's previous return and paid the appropriate Retailers' Occupation Tax on those receipts. If the retailer collected the corresponding Use Tax from the customer, the retailer should refund that tax to the customer. In addition, although this is not a warranty situation, you may wish to refer to 86 Ill. Adm. Code 140.141 of the Department's regulations, which discusses the tax obligations in a warranty transaction.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
Associate Counsel